Outlook for Austria

Austrian economy falls behind Eurozone average

Published in collaboration with
• Despite strong fundamentals, Austria’s economy lost some ground on the Eurozone average in 2014, with growth of just 0.4% compared with 0.9% for the Eurozone as a whole. This comparative weakness will also continue in 2015, with Austria’s GDP growth estimated at 1.1%, against 1.5% in the Eurozone. This is despite a boost from lower energy prices, quantitative easing from the European Central Bank (ECB) and a weaker euro.

• The main reason behind this weakness is the specialization of Austria’s exporters in investment goods and their strong orientation toward the Eurozone. While Eurozone GDP growth is set to strengthen considerably in 2015, investment spending remains subdued amid uncertainties, which translates into weak demand for Austrian exports. Only in 2016, when export growth gains traction again, will GDP growth pick up more strongly, to 2.1%, and surpass Eurozone average growth again. For 2017-19, we forecast the country’s GDP growth will average 1.9% a year.

• Moderate export growth in 2015 will mean equally moderate investment spending growth at home, driven mainly by replacement needs, until the outlook for investment brightens more noticeably in 2016.

• Household spending, which traditionally has a stabilizing effect on GDP growth, will post solid growth. We expect it to be lifted to 1% in 2015 and 1.5% in 2016 as lower inflation boosts households’ spending power.

• The bulk of state aid to some struggling banks has now been absorbed, and the fiscal deficit is expected to drop from 2.8% of GDP in 2014 to 1.8% in 2015, before narrowing further to 0.8% in 2016. This means the official deficit target of zero will be missed, as it now looks increasingly likely that not all of the consolidation measures initially envisaged will actually be implemented in time.

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GDP growth

<table>
<thead>
<tr>
<th>Year</th>
<th>Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>1.1%</td>
</tr>
<tr>
<td>2016</td>
<td>2.1%</td>
</tr>
</tbody>
</table>

Unemployment

<table>
<thead>
<tr>
<th>Year</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>5.1%</td>
</tr>
</tbody>
</table>

Consumer prices

<table>
<thead>
<tr>
<th>Year</th>
<th>Inflation</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>0.6%</td>
</tr>
</tbody>
</table>
Austrian economy falls behind Eurozone average

**Short-term growth outlook now weaker than the Eurozone’s ...**

As expected, Austria’s growth remained muted in Q4 2014 and the economy posted an expansion of just 0.4% for the year as whole, below the Eurozone average of 0.9%. This ended the five-year period during which Austria consistently posted significantly higher growth than the Eurozone as a whole, thanks to its stronger fundamentals, such as low unemployment, good credit availability and the absence of major economic imbalances.

The boost to growth from plunging oil prices, the ECB’s recently announced quantitative easing program, and the much weaker euro now expected in 2015 will also benefit the Austrian economy, but to a lesser extent. The main reason for this is that the boost to households’ spending power will remain relatively constrained, and that demand from the Eurozone for Austrian investment goods is set to grow more slowly amid ongoing uncertainty about the outlook.

We therefore expect Austria’s GDP to grow 1.1% in 2015, compared with 1.5% for the Eurozone. Only when external demand, especially from the Eurozone, improves further will economic growth – forecast at 2.1% in 2016 – overtake the Eurozone average. For 2017–19, we forecast average growth of 1.9%.

**... as a boost to household spending power from low inflation remains contained**

Household spending traditionally has a stabilizing impact on GDP growth in Austria. Remarkably, household spending continued to grow during the 2008-09 crisis and subsequent years, contracting just once, and even then only mildly, in 2013. This was the first contraction in 30 years. Household spending is helped by a relatively resilient labor market and significant social protection in the case of job losses. But equally important is the fact that households are used to tapping into their considerable net wealth, estimated at 120% of GDP, in order to smooth consumption.

### Table 1

**Austria (annual percentage changes unless specified)**

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>GDP</td>
<td>0.4</td>
<td>1.1</td>
<td>2.1</td>
<td>2.1</td>
<td>1.9</td>
<td>1.7</td>
</tr>
<tr>
<td>Private consumption</td>
<td>0.2</td>
<td>1.0</td>
<td>1.5</td>
<td>1.4</td>
<td>1.4</td>
<td>1.4</td>
</tr>
<tr>
<td>Fixed investment</td>
<td>0.5</td>
<td>0.1</td>
<td>3.2</td>
<td>2.4</td>
<td>1.6</td>
<td>1.4</td>
</tr>
<tr>
<td>Stockbuilding (% of GDP)</td>
<td>1.4</td>
<td>1.0</td>
<td>0.8</td>
<td>1.0</td>
<td>0.9</td>
<td>0.8</td>
</tr>
<tr>
<td>Government consumption</td>
<td>0.5</td>
<td>1.3</td>
<td>1.5</td>
<td>1.4</td>
<td>1.5</td>
<td>1.5</td>
</tr>
<tr>
<td>Exports of goods and services</td>
<td>1.0</td>
<td>2.2</td>
<td>5.9</td>
<td>5.1</td>
<td>4.9</td>
<td>4.4</td>
</tr>
<tr>
<td>Imports of goods and services</td>
<td>1.0</td>
<td>1.2</td>
<td>5.3</td>
<td>5.2</td>
<td>4.1</td>
<td>4.0</td>
</tr>
<tr>
<td>Consumer prices</td>
<td>1.5</td>
<td>0.6</td>
<td>1.6</td>
<td>1.9</td>
<td>1.8</td>
<td>1.8</td>
</tr>
<tr>
<td>Unemployment rate (level)</td>
<td>5.0</td>
<td>5.1</td>
<td>5.1</td>
<td>5.0</td>
<td>4.8</td>
<td>4.6</td>
</tr>
<tr>
<td>Current account balance (% of GDP)</td>
<td>1.0</td>
<td>2.3</td>
<td>2.4</td>
<td>2.5</td>
<td>2.6</td>
<td>2.6</td>
</tr>
<tr>
<td>Government budget (% of GDP)</td>
<td>-2.8</td>
<td>-1.8</td>
<td>-0.8</td>
<td>-0.6</td>
<td>-0.6</td>
<td>-0.6</td>
</tr>
<tr>
<td>Government debt (% of GDP)</td>
<td>82.9</td>
<td>82.4</td>
<td>80.1</td>
<td>77.8</td>
<td>75.6</td>
<td>73.6</td>
</tr>
<tr>
<td>ECB main refinancing rate (%)</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.3</td>
</tr>
<tr>
<td>Euro effective exchange rate (1995 = 100)</td>
<td>123.6</td>
<td>108.6</td>
<td>104.7</td>
<td>105.4</td>
<td>106.6</td>
<td>108.0</td>
</tr>
<tr>
<td>Exchange rate (US$ per €)</td>
<td>1.33</td>
<td>1.07</td>
<td>1.01</td>
<td>1.01</td>
<td>1.02</td>
<td>1.04</td>
</tr>
</tbody>
</table>

Source: Oxford Economics.
These factors will also determine household spending growth over the forecast horizon and in themselves justify our expectations of ongoing expansion. In addition, household spending power will receive a boost from the sharp fall in global oil prices that will be reflected in inflation dropping from an average of 1.5% in 2014 to 0.6% in 2015. However, the resulting increase in spending itself will remain relatively contained, as households will use part of the additional income to restore savings that have been drawn down in recent years in order to smooth consumption. As a result, we expect the robust 1.6% increase in real household incomes in 2015 to underpin consumer spending growth of 1%, up from 0.2% in 2014, with a rise to some 1.4% a year in 2016-19.

A moderate deterioration of the labor market, albeit from a very favorable base, will also limit incentives for stronger spending growth. Employment is likely to grow only slightly over the forecast period, as there is leeway to improve productivity by making better use of existing capacity rather than by hiring more people. At the same time, labor supply continues to increase, partly because of the Government’s efforts to raise the currently still very low effective retirement age of 58.5. This increase is also partly due to an influx of job seekers from the European Union (EU). Overall, we expect a slight increase in the unemployment rate (on the International Labour Organization measure) from 5% in 2014 to 5.1% in 2015 and for it to stay at this level until 2017, when it will begin to decline gradually.

Export recovery in 2015 held back by weak demand for investment goods from abroad ...

Much lower energy prices will certainly benefit consumers. They will also benefit the energy-intensive industrial sector, via lower prices for inputs and for intermediate consumption once these disinflationary pressures pass through the supply chain. Producer price inflation has been in negative territory since early 2013, and downward pressures are set to intensify in 2015.

Moreover, the euro has weakened significantly and is expected to fall close to parity with the US dollar by the end of 2015, and to remain close to this level throughout the forecast period. This will translate into a permanent improvement in the price competitiveness of Austrian exporters outside the Eurozone and should boost exports both in the short and medium term.
The boost from a weaker euro and low oil prices is needed. Austria’s exporters failed to connect to global demand potential in 2013–14, when exports grew at a much lower rate than import demand in the country’s trading partners. We estimate that potential demand from Austria’s trading partners rose by 6.5% in 2013–14, but export growth over the same period was only 1.5%.

This weakness is due to the fact that many of Austria’s exporters are specialized in investment goods, and that 73% of exports go to the EU, of which 55% go to the Eurozone. Against the background of persistent uncertainties about the growth outlook in Europe, investment activity in the continent has remained subdued and has resulted in weak demand for Austrian investment goods.

The impact is compounded by an unfavorable shift in export shares to lower growth countries in the aftermath of the 2008 crisis. In fact, among the countries to which exports have increased most are France, China and Russia, which together took 10% of total exports in 2013. For all of these nations, the growth outlook has remained weak or has been downgraded, with a deep recession expected for Russia in 2015.

At the same time, Austria has lost export share in economies that are expected to perform relatively strongly, such as the US and UK, which together took 7.5% of total exports. Against this background, Austrian exporters will start seeing growth more in line with potential demand only in 2016, when demand from the Eurozone, especially for investment goods, is set to strengthen. After estimated export growth of just 1% in 2014, we forecast that Austrian exports will expand by 2.2% in 2015, after which the rate should pick up sharply to 5.9% in 2016. We expect export growth to average 4.8% a year in 2017–19.

... translating into a belated pickup in investment spending

Moderate export growth in 2015 will translate into equally moderate investment spending growth in the same year, followed by a pickup in 2016. While capacity utilization in the industry is not particularly low, there is still some leeway for expansion of production without investment (by improving productivity) before the anticipation of constraints starts triggering stronger investment growth.

In the meantime, investment spending will be largely driven by replacement needs. After a meager rise of 0.5% in 2014, we expect even lower investment growth of 0.1% for 2015, largely due to the strongly negative end to 2014. We see the rate improving again to 3.2% in 2016, in line with a pickup in general activity, followed by an average of 1.8% a year in 2017–19.

Public finances remain relatively sound

Last year saw Austria’s budget deficit estimated at 2.8% of GDP, due to the absorption of the Government’s additional support to the banking sector. The deficit should narrow to 1.8% this year and 0.8% in 2016. This means that the Government will miss its balanced budget target for 2016, as it appears increasingly likely that not all planned consolidation measures will be implemented, or at least not in time, amid increasing dissent between the coalition parties about the details of the implementation.

Despite the Government missing its target, the fiscal position remains comparatively sound, with debt at about 83% of GDP in 2014, compared with 96% in the Eurozone overall. Very favorable financing conditions, with interest rates on 10-year government bonds in early 2015 well below 1%, should support the Government’s consolidation efforts.
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